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SUBJECT: NEW ZEALAND'S 2008 BUDGET - TOO LITTLE, TOO LATE.

Ref A) WELLINGTON 163

Ref B) WELLINGTON 159

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11. (SBU) Summary. The New Zealand Labour Party's 2008 Budget offered social expenditures and tax cuts in a last ditch appeal to voters in this election year where Labour lags badly in recent polls (see Ref A). It includes a three-year program of personal tax cuts, starting with an average rebate of NZ\$20 beginning just prior to this year's election (scheduled no later than November 15). The Opposition National Party criticized the size and timing of the tax cuts, but now faces calls to detail its own fiscal game plan for the country. For Labour, this budget represents the last remaining deliverable to persuade voters to return it to office. However, it is probably too little, too late. End Summary.

Cullen's Tax Cuts: Too Little Too Late?

12. (U) New Zealand Finance Minister, also Deputy Prime Minister, Dr. Michael Cullen unveiled in his annual Budget speech to Parliament on May 22 a NZ\$10.6 (US\$8.25) billion package of tax cuts to be rolled out over the next three years. The Government estimates the budget's tax cuts and higher government spending will equate to 2.3 percent of gross domestic product (GDP) over the course of the fiscal year. Cullen told Parliament that his three-year program will deliver between NZ\$12 and NZ\$28 a week more in take home pay from October this year, rising to between NZ\$22 and NZ\$55 a week by April 2011. These long anticipated tax cuts will cost the government about NZ\$1.5 billion in first year and escalate to NZ\$10.6 billion in total by 2011.

13. (U) Inflation adjustments to the Working for Families entitlements (welfare benefits for families) will also be brought forward from April 1 next year to October 1 this year. The net effect would give a two-income couple with three children under age 13 and combined earnings of NZ\$65,000 an additional NZ\$45 a week beginning October 1, 2008 and increasing to NZ\$90 a week by April 12011. For retirees, the New Zealand Superannuation Fund benefits will add \$45.88 for a married couple and \$23.84 for a single person living alone on pension.

The Budget: Something for Everybody

14. (U) The Government of New Zealand has projected it will collect NZ\$61.9 billion in revenue in the 2008/9 fiscal cycle, which amounts to approximately 33.4 percent of total GDP (NZ\$185 billion or US\$145 billion). The three largest sources of this revenue are individual income taxes amounting to NZ\$27.2 billion, GST of NZ\$11.9 billion and corporate taxes of NZ\$9.6 billion. The Government will spend the NZ\$61.9 billion in 2008/09 as follows:

- Health NZ\$12.6 billion
- Education NZ\$10.5 billion
- Social Security & welfare NZ\$9.2 billion
- NZ Superannuation Fund (pension scheme) NZ\$7.8 billion
- Primary services NZ\$5.7 billion
- Core government services NZ\$3.4 billion
- Law and order NZ\$3.1 billion
- Transport & communications NZ\$2.8 billion
- Economic & industrial services NZ\$2.4 billion
- Defense NZ\$1.7 billion

COMMENT: This list reflects the priority this government has placed on social expenditures over economic development and national security throughout its tenure in office. END COMMENT.

15. (U) Highlights in the Budget intended to garner the favor of voters include:

- NZ\$3 billion for improved health services over four years; NZ\$2 billion of which will go to district health boards to cover the increased costs for goods and services and population increases.
- NZ\$1.8 billion for teachers' salary increases over five years (NZ\$619 million in 2008).
- NZ\$215 million to hire 762 additional teachers over four years to reduce class sizes to one teacher per 15 students.
- NZ\$690 million for Toll rail operations -- the previously announced NZ\$665 million purchase price plus \$25m to cover the costs of lease arrangements and staff presented as an improvement in the

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transport sector. See Ref B.

- NZ\$500 million effort to improve high-speed broadband in urban areas and extend its reach into rural regions.
- NZ\$189.5 million to hire 1,000 additional policemen.

Reaction by Business

16. (U) Roger Kerr, Executive Director of the New Zealand Business Roundtable reacted to the 2008 Budget saying, we "called for all high [personal] income tax rates to be reduced and aligned with the company tax rate of 30 percent as a step in the right direction." Instead, the government widened rather than flattened the tax scale by reducing only the bottom personal tax rate, and the threshold adjustments did little to improve incentives for productive activity. The government focused on short-term relief to household budgets. Expressing a position, which may be taken up by the National Party, Kerr went on to say, "with greater spending discipline and growth-oriented tax changes, much larger tax reductions could have been implemented without putting at risk inflation and a sound fiscal position." He further warned that government spending as a share of the economy is forecast to rise rather than fall (by around 1.5 percent of GDP between 2008 and 2010), indicating that the true ongoing tax burden is rising rather than falling.

Reserve Bank May Keep Interest Rates High

17. (U) The cuts in personal income tax rates may amount to a zero sum benefit if the Reserve Bank of New Zealand (RBNZ) continues its current tight monetary policy. Initially many local economists had been predicting the Reserve Bank of New Zealand (RBNZ - NZ's central bank) would begin cutting the official cash rate (OCR now 8.25%) by September '08, amid growing evidence of a sharp economic slowdown but those same economists are now forecasting that the cuts could be much more "stimulatory" (inflationary) than had been anticipated. The RBNZ had been expecting only NZ\$1.5 billion in tax cuts to take effect in April next year leading to possible reduction in the OCR

by September '08, but economists now expect the OCR will remain high until at least March '09.

Support Parties Got Their Share

¶8. (U) In terms of voting blocs, it is possible that the beneficiaries will not be Labour, but rather its key support parties. Although New Zealand First's Winston Peters wanted more tax concessions and policies to support local industry, he will take credit for increases to superannuation and increased support for older New Zealanders. The Greens wanted to hold back on tax cuts and instead bolster social spending. However, they will nonetheless take credit for budget allocations for energy efficiency and environmental cleanup.

National Party Slams Budget

¶9. (U) Opposition leader John Key reacted to the 2008 budget by criticizing Labour's economic stewardship over its nine years in office and its failure to offer tax cuts before now. Key argued that Labour had accumulated large surpluses by overtaxing New Zealanders over the past nine years and reminded voters that no finance minister in New Zealand history has had the opportunity to cut taxes like Cullen. Key is confident that New Zealanders will see Cullen's decision to finally deliver tax cuts just prior to the election as "the desperate and cynical move it is". Key also focused on size of the tax cut for the average wage earner - NZ\$20 a week - which he criticized as too small to offset rising living costs. He called the cuts too little even to buy the average Kiwi family one more block of cheese every week.

¶10. (U) Key resisted calls by Labour to make known the exact size of National's own tax cut program. He did state that tax cuts are a top priority for National and that it would "reprioritize" government spending, without providing more details about which of Labour's policies it would discard. Key acknowledged that National will need to present its own budgetary vision before it faces credibility issues of its own. Key said he would probably wait

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until the start of the election campaign before unveiling its own economic package. Despite its criticism, National voted in support of the Budget as it passed in an urgency session in Parliament on May 23. National agreed that a vote against any sort of fiscal relief for voters at this time would be politically damaging.

COMMENT: Budget Still Not A Vote Winner

¶11. (SBU) The 2008 Budget was uniformly regarded by media political analysts as a bold budget of its sort, particularly for the traditionally parsimonious Cullen. It will not, however, be a sufficient spark to reignite Labour's flagging political fortunes. (Note: The May 17 Fairfax Media poll showed National had a 27-point lead over Labour. End Note). Now that Labour have shown its budgetary cards, they will try to pressure Key to state clearly not only the scale of any tax cuts National will make but also, and most critically, how they will be paid for. Key will delay responding as long as possible, knowing that the longer National stays silent, the longer the media and voters will focus on Labour's shortcomings. End Comment.

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